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TAGS: ECON EAID EFIN PREF ENRG GZ IS
SUBJECT: PALESTINIAN AUTHORITY PRESSES GAZA ELECTRIC
COMPANY TO END ITS DEPENDENCE ON SUBSIDIES

Classified By: Consul General Daniel Rubinstein for reasons 1.4 b, d

¶1. (C) Summary. In a calculated move to decrease its financial burdens and increase the fiscal sustainability of the Gaza Strip's only electrical power plant, the Palestinian Authority (PA) is cutting back its payments for the plant's industrial fuel. The PA's goal is to press the Gaza Electricity Distribution Company (GEDCO) to increase revenue collection and contribute to its operational costs. The ensuing shortage of fuel forced GEDCO to shut down one of its two turbines on January 23, resulting in daily blackouts of 8 to 16 hours. Additional fuel was sent into Gaza on January 28 after GEDCO contributed NIS 5 million toward fuel costs. This is expected to keep the one currently functioning turbine running through the end of January. End summary.

PA Steps In After EC Subsidies End

¶2. (C) The PA began making direct payments GEDCO's industrial fuel after the European Commission (EC) ceased payments in November 2009 and redirected its assistance to other PA needs. The EC had paid for the maximum amount of industrial fuel allowed by the GOI into Gaza since it began its subsidy program in 2006, around 9 million liters per month at a monthly cost of approximately USD 12 to 14 million (depending on the oil price). According to Roy Dickinson, EC Head of Coordination, the EC had always planned to phase out the fuel program, as it did with other direct subsidies in Gaza, but two factors significantly influenced the timing of their decision.

¶3. (C) First, Dickinson said, European auditors issued a report in late 2008 stating that paying VAT and excise on the fuel transfers was problematic. The EC attempted to negotiate with the GOI for a tax exemption without success. Second, in October 2009, when the PA asked GEDCO to contribute to the fuel cost, Dickinson claimed that Hamas prohibited GEDCO from doing so. Shortly thereafter, the EC decided to stop fuel subsidies because they possibly benefited Hamas, according to Dickinson. He added that it was also difficult to promote reforms in net lending as long as the PA was protected from the real costs of the fuel transfers.

PA Fiscal Retrenchment Holds GEDCO Accountable
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¶4. (C) In the two months following the end of the EC program

(December 2009 and January 2010), the PA paid USD 10 million per month, approximately USD 2 million below the EC's funding, according to PA officials. Dr. Omar Kittaneh, Chairman of the Palestinian Energy Authority, said that the PA expects GEDCO to pay the difference between PA contributions and the monthly cost of the GOI cap for industrial fuel.

¶5. (C) PA Prime Minister Salam Fayyad told the Consul General on January 26 that a graduated decrease of PA payments for GEDCO's fuel is part of a plan of fiscal retrenchment by the PA. He emphasized that the cost of subsidizing the plant was exorbitant and accused GEDCO of doing little to collect revenue from consumers. It was imperative, Fayyad said, that the power plant put its books in order and make a genuine effort to collect electricity payments and contribute to the cost of fuel. In order to force GEDCO to increase its accountability, Fayyad said that the PA would reduce monthly payments by USD one million per month, "down to zero."

¶6. (SBU) Recent PA press statements struck a more nuanced note, attributing the difficulty of the situation to the EC's decision to end its fuel subsidies, while stressing the PA's current role in paying for fuel and GEDCO's responsibility to provide collection revenues to contribute to its operational costs. Note: A cover note to the PA's draft 2010 budget, provided in confidence to Econoffs, states that the PA is expecting net lending to decline by USD 80 million from the 2009 level, due partially to "greater collection efforts by GEDCO." End note.

¶7. (C) In response to the decrease in fuel payments and subsequent electricity cutoffs, GEDCO transferred NIS 5 million to the PA on January 27. As a result, the power plant was expected to receive 500,000 liters on January 28, allowing one of its two turbines (generating 30 MW) to keep running at least until January 31, according to Dr. Rafiq Al Malihi, director general of the plant. With the PA's payments for February, Gaza should receive enough industrial fuel during the week of February 1 to run both turbines (generating 60MW). Both GEDCO Director General Suhail Skeik and Kittaneh expect financing problems in the second half of February, resulting in fuel shortages again.

¶8. (C) In addition to the power plant, the Gaza Strip receives electricity through feeder lines: 120MW from Israel (paid by the PA through deductions in clearance revenues) and 17MW from Egypt ("sometimes" donated by the Egyptian government, according to Skeik). The demand for electricity in Gaza is approximately 270 MW per day.

Increasing Collection Rates, Accountability to Cover the Gap

¶9. (C) Mazen Jadallah, Director General of the Ministry of Finance (MoF), said that the MoF is prepared to finance any measures that will increase the collection rate for electricity usage in Gaza. Kittaneh suggested that the PA invest in 100,000 prepaid meters and train GEDCO employees in their use. However, Skeik warned of the difficult operating environment in Gaza, with considerable poverty and a likelihood that pre-paid meters may be destroyed if installed. Skeik estimated that GEDCO's 160,000 subscribers consume NIS 50 million worth of electricity monthly. He claimed that GEDCO collected approximately NIS 20 million in revenue in January, of which NIS 3 million went to pay for salaries, spare parts, and other overhead expenses. Skeik calculated NIS 2.2 billion in unpaid electricity bills since GEDCO's founding in 1998. (The establishment of GEDCO preceded the construction of the power plant, which went into operation in 2003.)

¶10. (C) While acknowledging GEDCO's overhead expenses, Kittaneh also noted that no auditing is done of GEDCO's expenditures and that there is no transparency as to how it is spent. To illustrate this, Jadallah said that as of late October 2009, GEDCO held NIS 26 million in the bank. In the

same month, the PA MoF asked GEDCO to use these funds to support fuel costs. Two days later, Jadallah claimed, the GEDCO account showed a zero balance.

¶11. (C) In addition to the cost of fuel, Kittaneh mentioned GEDCO's obligation to make "capacity" payments -- dues paid to the investors in the power plant, amounting to approximately USD 3 to 3.5 million per month, including arrears. "Otherwise, the power plant could not operate," said Kittaneh. He also noted that the amount of arrears was reduced from tens of millions of dollars to the current amount of five or six million dollars. A well-connected Gaza businessman, Maamoun Abu Shahla, suggested that GEDCO makes these payments on an annual basis; Jadallah confirmed that the MoF is not involved.

¶12. (SBU) As the issue remains politically sensitive, the details of "capacity" payments remain unclear, though they may explain where some of GEDCO's collected revenues go. The investors in the plant include Consolidated Contractors Company (CCC), Palestinian Development and Investment Company (PADICO), Arab Bank, Arab Palestinian Investment Company (APIC) and Palestine Investment Fund (PIF).

Shortfall Could be Covered by Donors

¶13. (C) Despite the cuts made to fuel subsidies, the EC's overall assistance allocation to the PA has not dropped substantially. The EC has kept their staff in place at the Kerem Shalom crossing point between Gaza and Israel and the power plant, so as to monitor invoicing and delivery of fuel payments and to help build PA capacity to oversee the transfers. Dickinson also pointed out that the program mechanism (PEGASE) is still open to other donors, meaning

that EU member countries could still earmark aid to support fuel purchases, with the funding channeled through PEGASE. The Swiss government has already committed approximately USD 1.9 million, and Dickinson said that there was a second (unnamed) donor considering making a USD 20 million contribution.

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